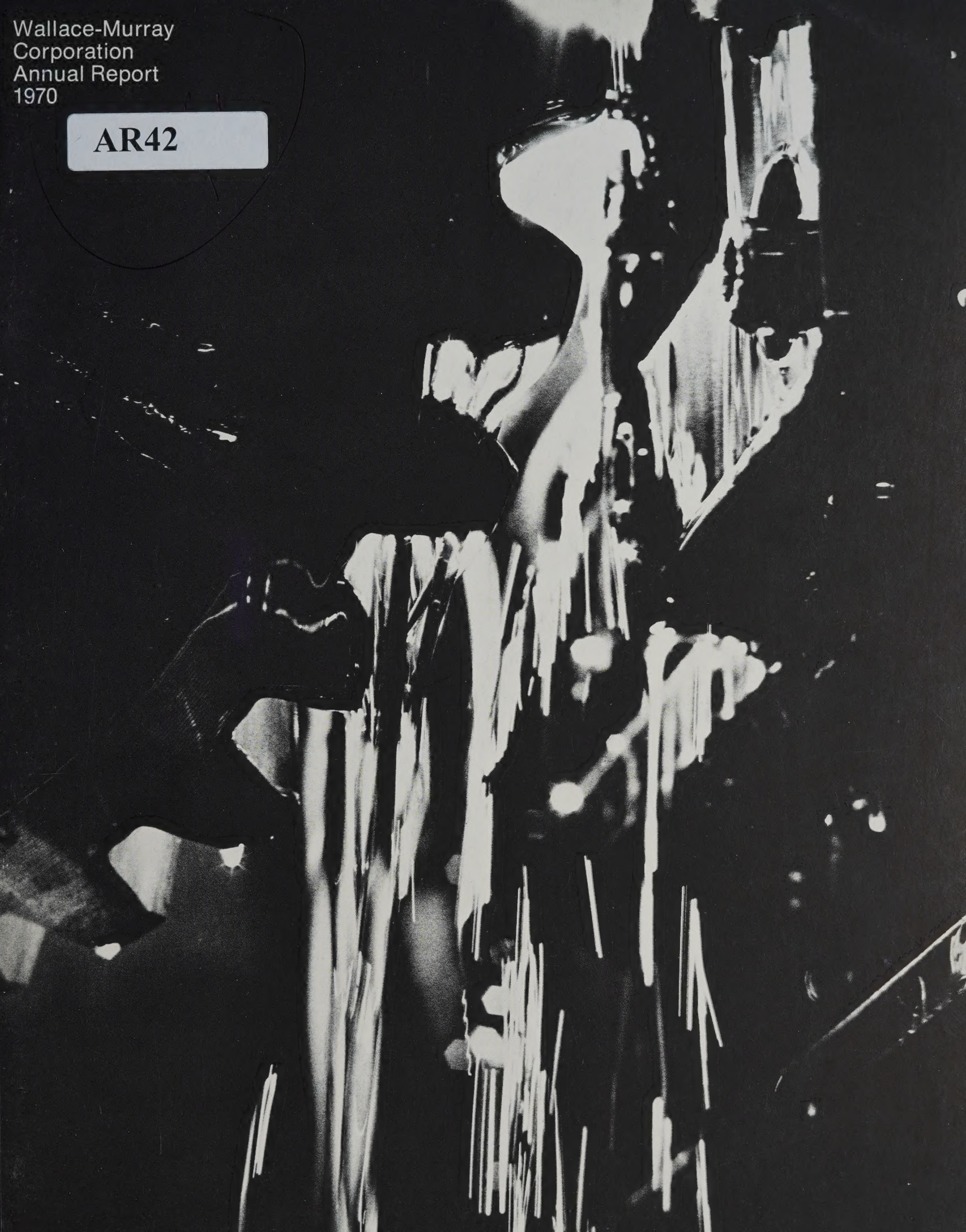
Wallace-Murray
Corporation
Annual Report
1970



Wallace-Murray Corporation Annual Report 1970

Financial Highlights

	1970	1969*
Net Sales	$205,604,225	$241,289,566
Net Income	6,009,419	11,863,035
Average Number of Common Shares Outstanding	2,871,319	2,878,229
Earnings Per Common Share—Assuming no Dilution	$1.47	$3.48
Average Number of Shares Outstanding, Assuming Full Dilution	4,343,874	4,378,047
Fully Diluted Earnings Per Share	$1.30	$2.63
Cash Flow	13,055,607	18,557,535
Depreciation	7,046,188	6,694,500
Capital Expenditures	10,668,770	11,164,099
Working Capital	60,977,516	59,789,197
Long-Term Debt	58,940,143	54,318,073
Stockholders' Equity	81,850,242	81,294,470

*Restated to reflect company acquired in a pooling of interests transaction.

Fully diluted earnings per share assumes full conversion of $1.70 Cumulative Convertible Preference Stock and exercise of Common Stock warrants.

On the cover:

Custom gears, bathed in oil, are machined to precision specifications at Wallace-Murray's Illinois Gear plant in Chicago, Illinois. During 1970, this plant was extensively expanded and modernized.

Building Products	plumbingware systems plumbing fixtures plumbing brass metal chimneys gas vents and vent tops woodcutting tools registers and grills diffusers metal building products steel stampings	40%
Cutting Tools	industrial saws machine knives circular cutters carbide tools and burs hammers, files, rasps grinding wheels abrasive grains steel specialties	30%
Power Components	turbochargers air conveyors superchargers cooling fans fan drives dampers air pumps fluid-power devices hydraulic components	20%
Custom Metal Products	high alloy steels magnetic metals industrial gears custom machine parts controlled expansion metals high temperature alloys gear racks sprockets heat treating	10%

Wallace-Murray Markets:

In 1970, Wallace-Murray reorganized its 12 operating divisions into product groups which parallel its principal marketing thrusts. These four major markets as illustrated on the facing page—building products, cutting tools, power components and custom metal products—present real challenge and promise for the seventies.

The Building Products Group comprises the Eljer Plumbingware, William Wallace, Lawton-Scharf, Selkirk-Metalbestos and Dry Divisions. It includes one of the nation's largest distribution networks of plumbingware and related equipment directed to the mobile and modular home industry. We have made a substantial commitment to this concept because we believe it represents one of the most realistic ways to bridge the enormous gap which will exist, for the next decade at least, between demand and supply of new housing units.

Our concentration on conventional housing, residential and institutional, also anticipates the systematization of construction techniques. Wallace-Murray has strong trade and consumer ties, developed over two-thirds of a century. We mean to retain these. At the same time, we know that new efficiencies in the management of heat, water, air and their wastes are technically possible, and we plan to be a significant factor in their introduction and development.

Wallace-Murray's cutting tools are sold under such well-known names as Simonds, Heller and Atrax. Together, they serve a broad spectrum of American industry from the heavy-duty circular band saws used in a lumber mill to the most minute, sophisticated carbide drills used in computer circuit board manufacture. Expansion and internal reorganization has positioned this group to capitalize on growth opportunities, particularly in the carbide markets.

By their nature, the products of the Power Components Group are tied to over-all production of automobiles, trucks and off-highway equipment. But even within this limit there remains enormous room for growth. Air-conveying is a new and growing market in which our Schwitzer Division is a leading participant. Power-boosting and air-conditioning, once considered luxuries, are becoming standard equipment. Therefore, even in 1970, we have continued to expand plant capacity and increase production efficiency for both these product groups.

The Custom Metals Group addresses itself to a sophisticated market where tolerances, stability and quality are essential. Some of our new specialty steels have been developed to meet space age requirements, while the custom gears manufactured in the newly completed heat treating facilities of our Illinois Gear Division meet the critical specifications of customers who require a reliable product that operates faster, more efficiently and at a lower cost.

Meeting the Challenges of 1970:

You have read and heard enough about the 1970 recession in the national economy to obviate the need for comment by us.

As for Wallace-Murray, we pointed out in last year's Annual Report that we had selected as the main thrust of our activity the satisfaction of fundamental needs within our society that were real, substantial and susceptible to solution. They include housing, the effort to increase efficiency in mass transportation, the improvement of manufacturing processes.

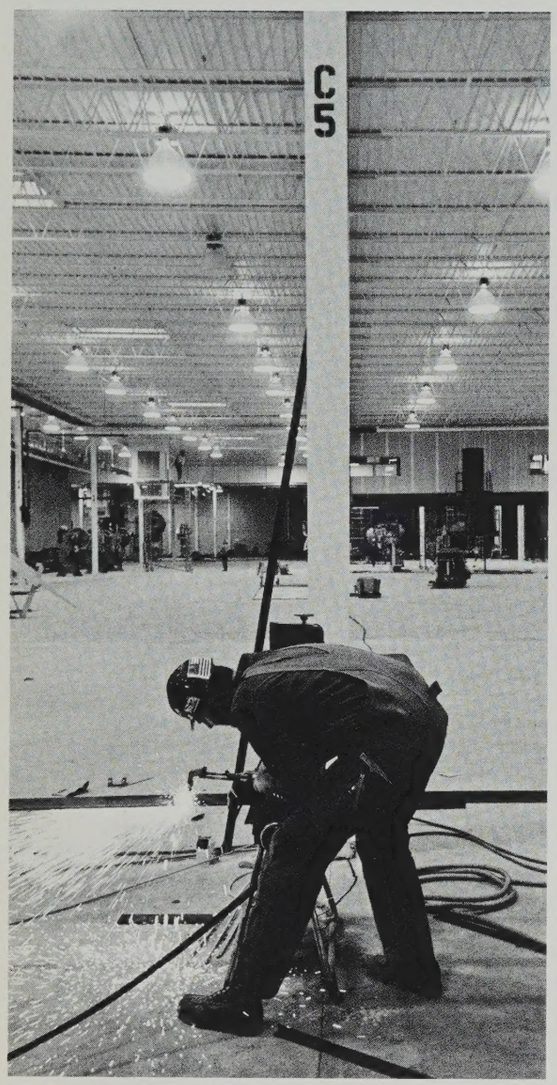
A year has passed and these needs still exist. The fact that their satisfaction has been largely deferred only makes them more acute.

Unlike items of discretionary spending which may disappear if deferred, Wallace-Murray's potential markets remain. A house which was not built, a better power system which was not installed, needed but postponed machinery and tooling remain potential units of business yet to be realized. We anticipate that to an increasing degree, these needs will be met in the periods ahead.

In the meantime, we have not remained passive. To the contrary, there is a great deal that can be done about developing new products, about expanding our share of the markets in which we compete, about modernizing our production facilities and reducing costs. This we have done.

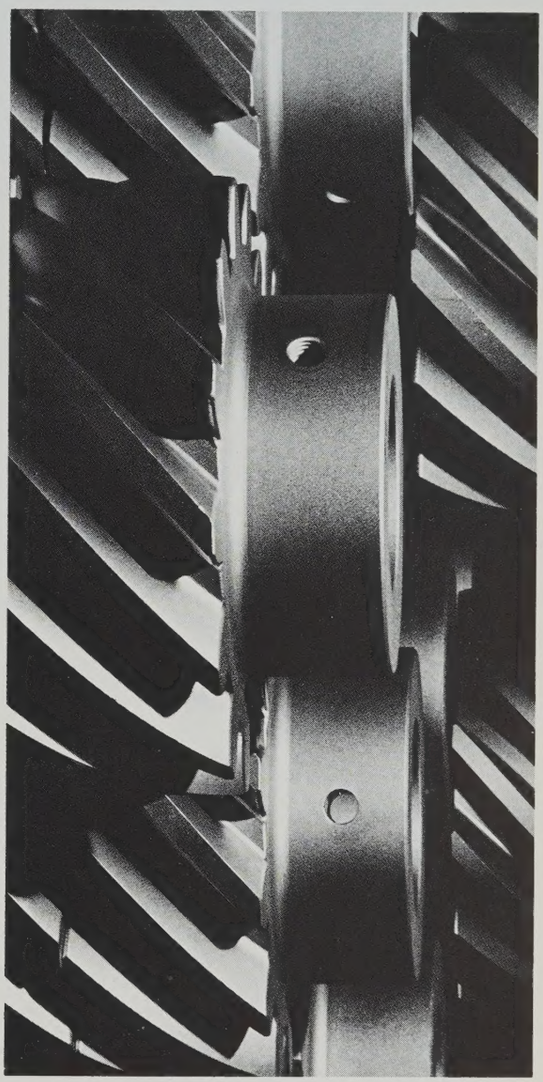
The narrative section of this Report deals with three specific program areas that Wallace-Murray tackled in 1970—facilities planning, new product development and market penetration. Together, they provide an answer to the question: "What should a company do, even during a less than satisfactory year, to prepare itself for the future?"

Facilities Planning



Product Development

Market Penetration



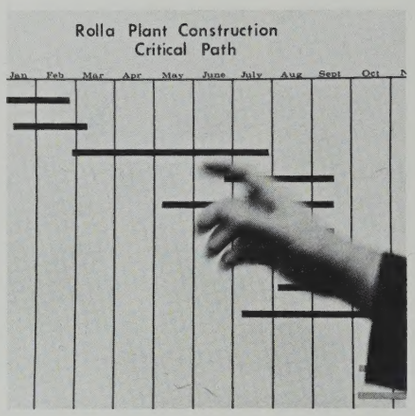
A recurring phrase in annual reports is "Ground was broken for a new plant in...." Wallace-Murray said it last year in announcing a program to expand and modernize the production facilities of the Schwitzer Division. The new plant is now in operation. But between that first announcement and this one, much happened.

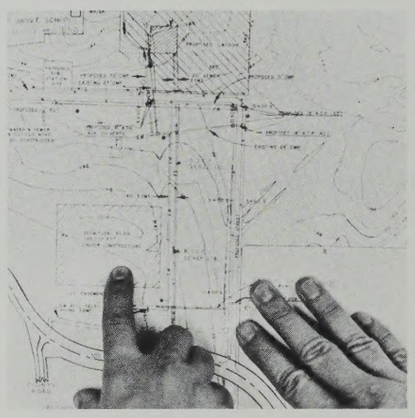
Schwitzer is the nation's largest producer of turbochargers and one of the nation's leading manufacturers of specialty automotive components. It has a long record of innovation in the field and, like many well-established companies, it has had intermittent growing pains. It became apparent in 1968 that full capacity of the main plant in Indianapolis was rapidly being reached with no room left for expansion. At the same time, market projections showed—and still show—substantial room for growth and a clear potential for development of new products. Unless something was done to solve the problem it would be difficult and costly to realize this potential.

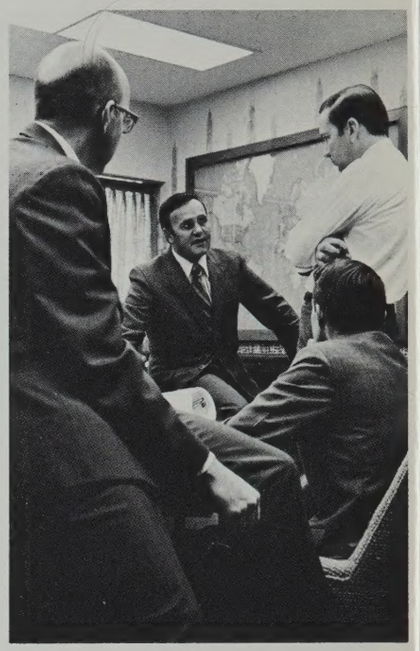
The alternatives were: build one or more satellite plants; remove some services—research, engineering—to another location; or, because this was a multi-product plant, move some product lines out altogether. Each alternative had problems: location in relation to markets and materials; availability of skilled labor; deployment of supervision and control; the relationship of the new plant to the present one. And, of course, basic questions of cost and service.

Following extensive study, the decision was made—move, and move one entire product line. Eliminate long distance control problems by making the new plant self-contained, self-sufficient, self-operating. Once the move is made, space in the present plant automatically becomes available for expansion, with a minimum of dislocations.

Because of the poor year experienced by the automotive industry, Schwitzer *could* have turned current production out of its present plant. But times change—are changing. If anything, a hard year is a good year in which to anticipate these changes. Now, the project is completed; the new plant is running. Gains in efficiency are being realized in terms of more favorable costs to help offset constant inflationary pressures. As demand rises —not only demand caused by a general up-turn, but demand created through the development of new, better products—it is reasonable to expect these efficiencies will be magnified.

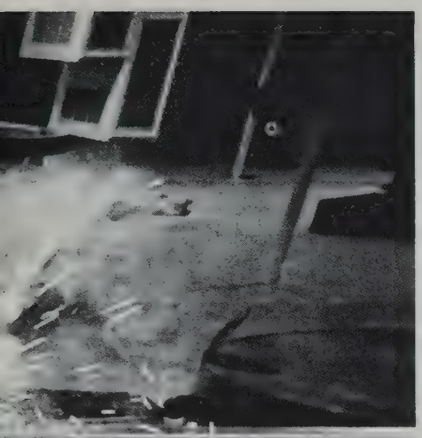




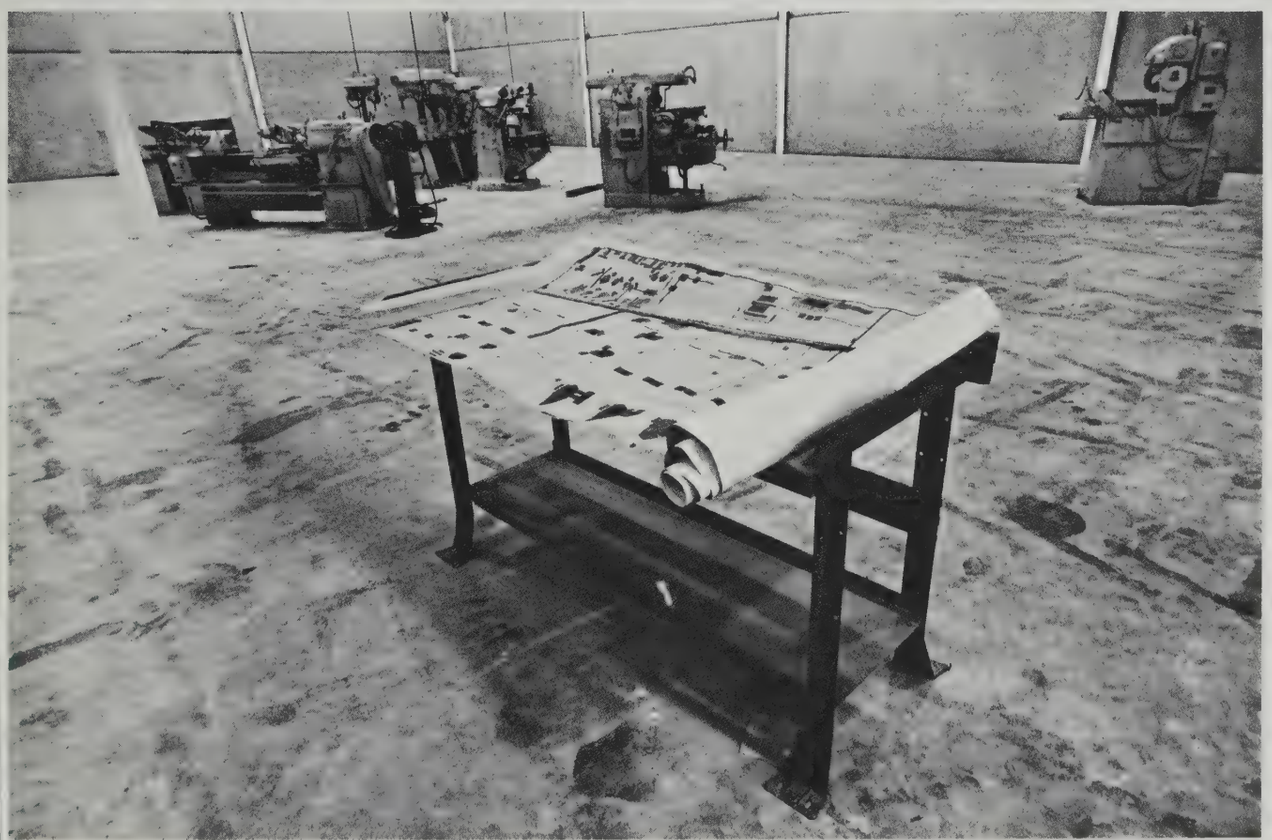


The entire automotive fan operation, (right) was chosen for relocation. Since this process does not require as high an input of skilled mechanics, the net effect of its departure has been the continued availability of expert hands for production of turbochargers which have a higher design technology, and which represent a growing market in which Schwitzer can now more forcefully compete. Once the move was decided, modern techniques of evaluation and control were instituted to see it through to completion.

Rolla, Missouri was selected because it was convenient to customers and raw material sources, because it had a good labor supply and a fine engineering school, because it met power water and transportation requirements, because it was hospitable to industry, and not least because it offers an attractive community setting for employees.

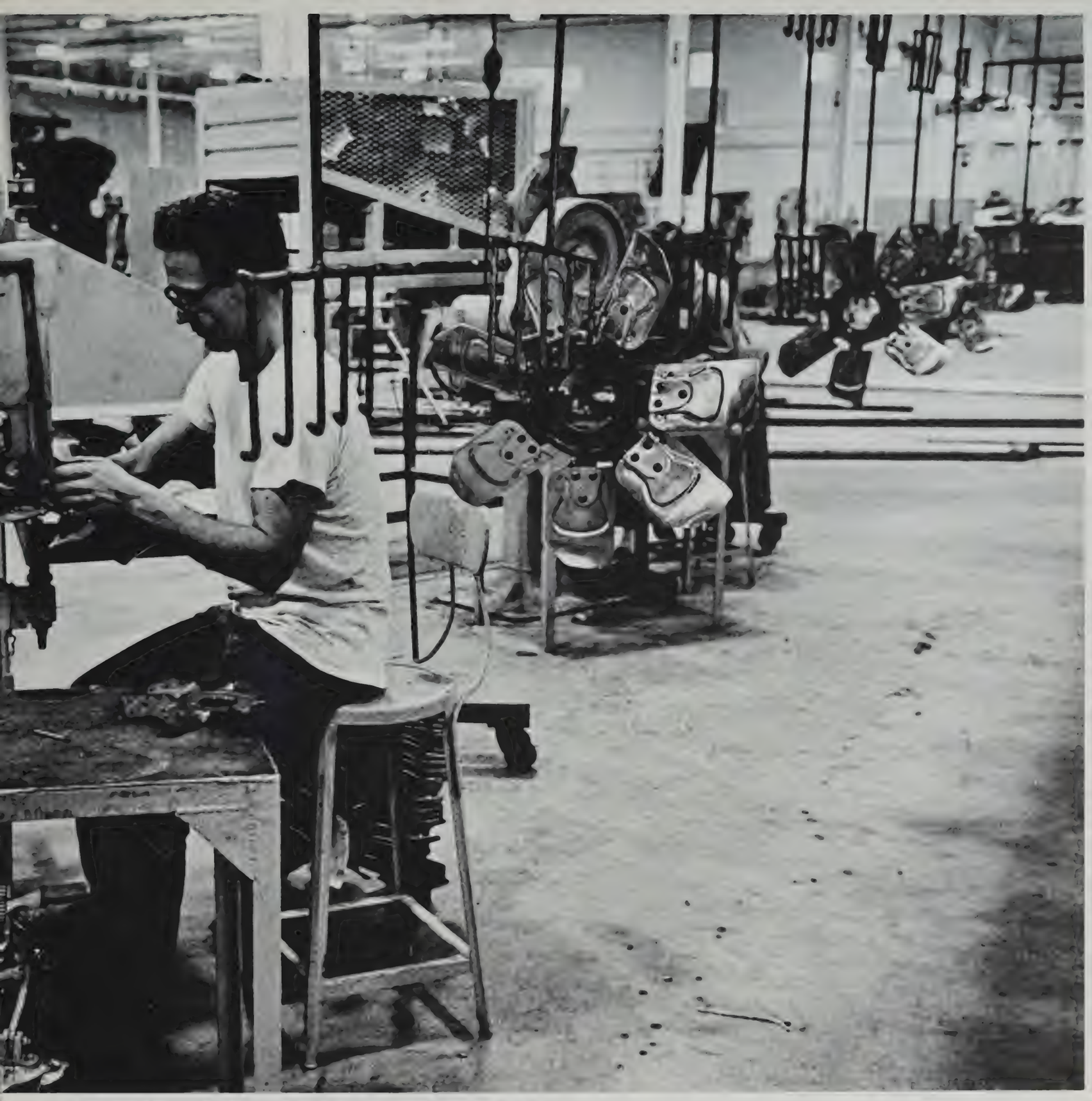


By building a modern plant to house a complete product line, it has been possible to realize greater control over existing manufacturing costs which have been rising in the old plant. For instance, through an orderly flow of production, it will be possible to maintain lower inventories. By providing facilities for a wider range of products, the new plant will also permit the sales effort to encompass a wider marketing area.



New plant (above) is the first occupant of a newly-opened industrial park. The basic planning (left) anticipated an expansion of capacity.

One of Rolla's most persuasive attractions was the existence of a highly trainable, well-motivated labor pool. A technical school (below, right) was established by Schwitzer in association with government and local authorities to train our own people. Wallace-Murray has become the largest industrial employer in the area, and the level of enthusiasm in the community is a good augur for the future.



From its new home now in full operation (above) Schwitzer is better equipped to expand into new product areas (such as flexible bladed fans) and into new product applications for existing markets. The new plant is designed for straightline flow and in-process storage, giving it wide manufacturing flexibility and permitting full or partial automation as soon as this becomes economically desirable.

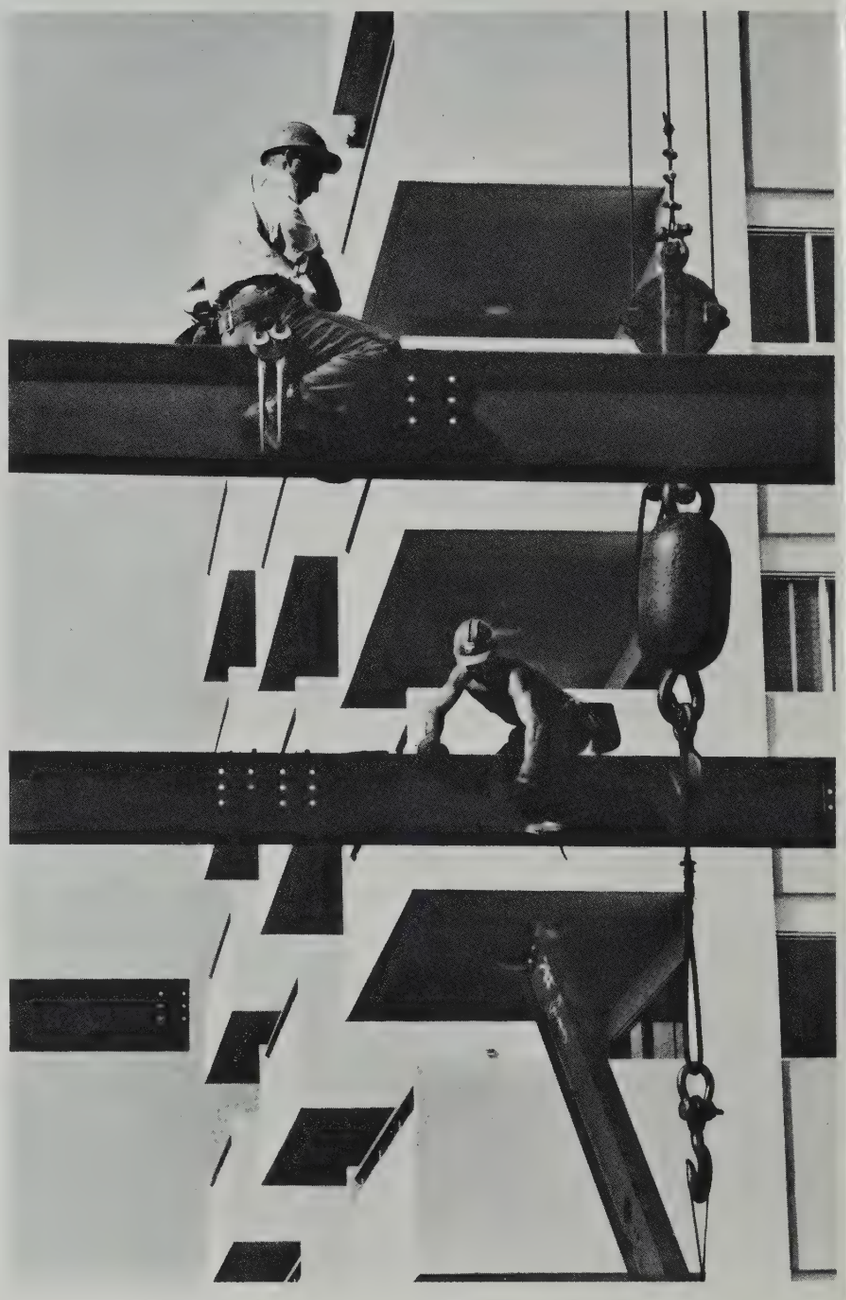
Four-tenths of Wallace-Murray's business is related to building, an industry faced with the problem of creating more new housing in the next three decades than in the past three centuries. Clearly, old techniques and materials won't do it. Equally clearly, the industry and its related trade and labor entities will not scrap existing products and techniques overnight. Nor would this solve the problem. The challenge, and therefore the opportunity, is to find selective application for new technology which is responsive to needs, but which also carries realistic likelihood of acceptance by builders, architects and the public.

One application studied by Eljer is the use of modular techniques in the design and installation of a complete bathroom, for institutional as well as residential use. (Modular has many meanings. In ours, it describes a unit which is delivered to the site in three-dimensional form, with much of the time and money-consuming assembly already done.) A modular bathroom system has many appeals: it is economical to the buyer, yet allows Eljer to supply a larger part of the total house; it has competitive advantages; it permits us to use existing components; it is acceptable to our present patterns of distribution; it affords great architectural flexibility; it can be used for remodeling as well as new building; it requires no special equipment or skills to install.

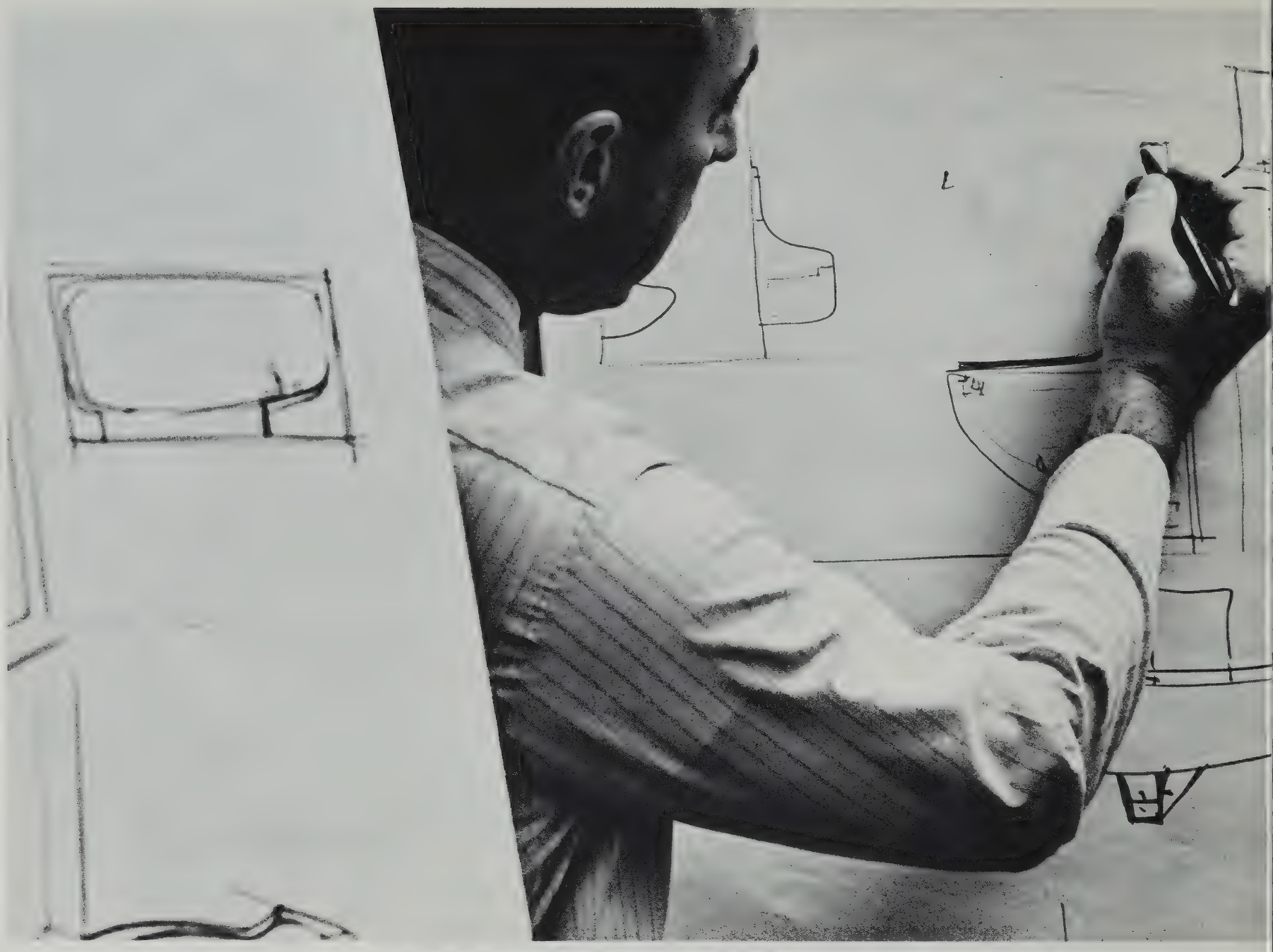
It is difficult to pin-point the exact genesis of a new product. The modular bathroom has been on the drawing boards for some time, but it took shape as a new product during the past year when the many dimensions of demand were pin-pointed.

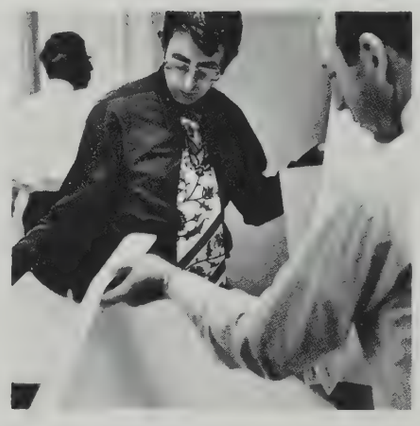
Sizes were established; one major problem was solved: the Eljer module permits all plumbing to be kept out of the wall by providing a complete wall section that shrouds the piping system; another problem, shipping costs, was overcome by a design which allows packaging in tightly-nested boxes; flexibility was provided in color, texture, finish, and in adaptability to configurations suitable for schools, hospitals, gymnasiums, public buildings.

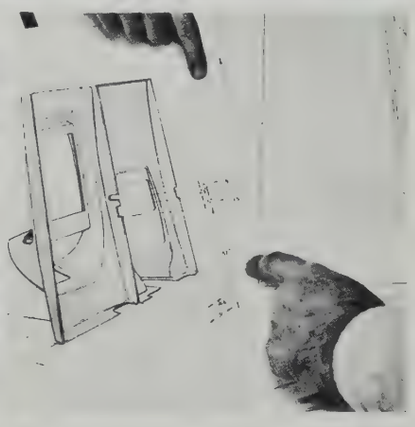
Eljer's plastic fiberglass modular concept was presented to the public—its public—at the National Association of Home Builders Show in January, 1971. The response was excellent: a realistic way to solve an existing problem. A measure of opportunity? Final market studies will determine that.



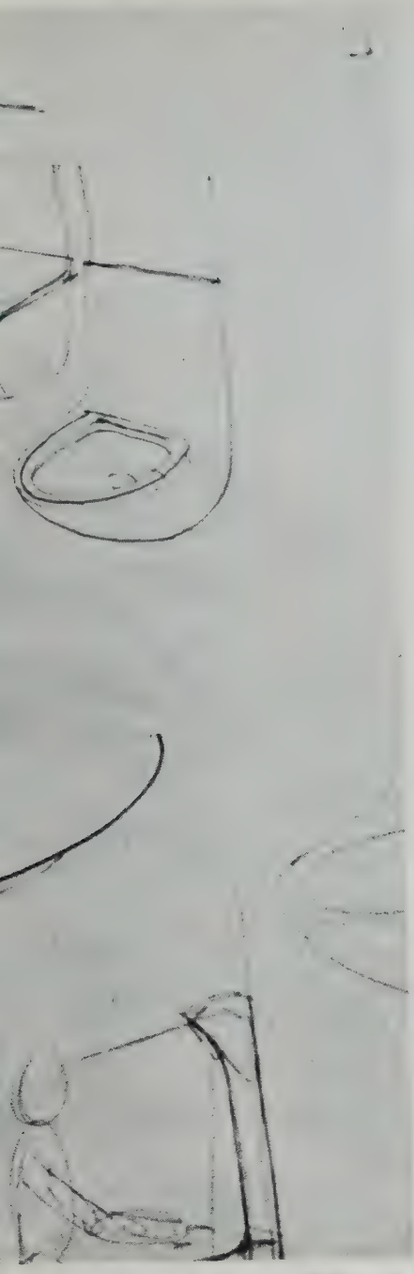
New construction (above) and new design (right) illustrate graphically the simple but stubborn problem central to the housing crisis. Costs, more than any other single factor, determine the degree to which demand can approach satisfaction. One of the most sought-after ways to cut costs is by injecting techniques of industrial mass production.

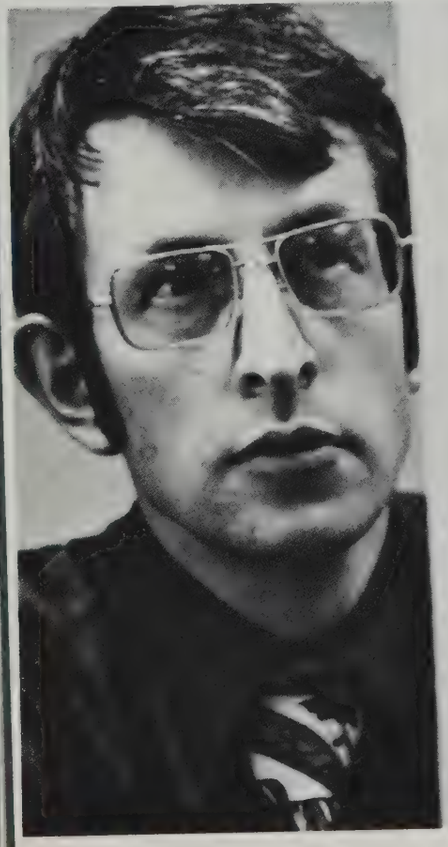




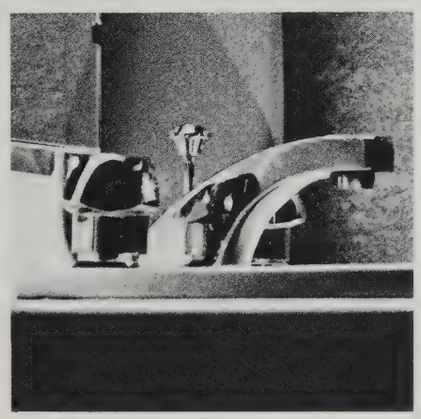


Typically, mass production entails a concession to standardization and rigidity of design which has often proved unacceptable in the building industry. In all the development stages of the Eljer module, from the first drawings (above) through progressive mock-ups (right), flexibility has been a key criterion. Another has been the risk of creating self-defeating innovation. Eljer is already a major factor in the plumbing industry. Solution: a system (far right) which readily accepts existing Eljer iron, steel or china fixtures, but which competes successfully on its own terms.





Finished modular bathroom is shown at right in a typical residential configuration. Design allows latitude in selecting components such as mirror and storage cabinet in wall panel, racks, shelves, table surface. Visitors to Eljer trade exhibits (below) have commented favorably on design, concept, ease of installation and maintenance, practicability of module in terms of construction requirements and consumer preferences.



Original design envisages the integration of brass (left) as part of basic unit. This assures better customer satisfaction, and increases Eljer's share in the total package.

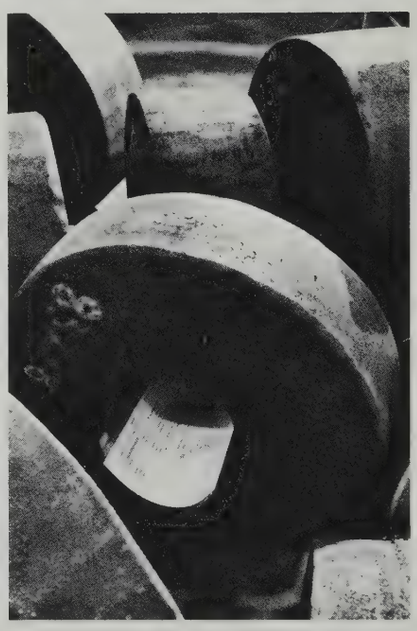
Market Penetration

If one were to devise an industry with desirable long term prospects, its profile might well include a counter-cyclical factor, the opportunity to build and hold a competitive edge, protection against instant obsolescence, responsiveness to the infusion of new capital.

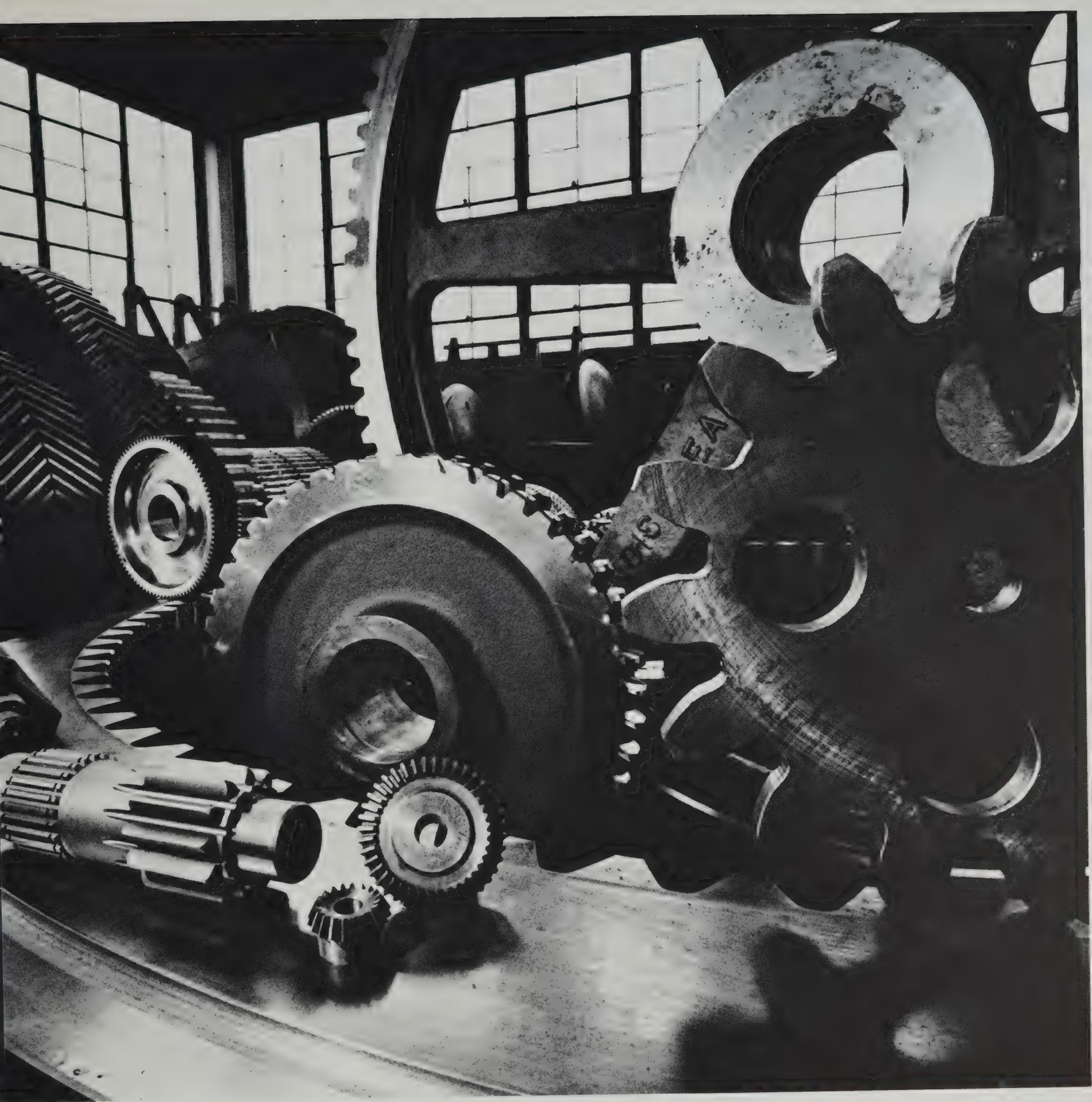
The custom gear industry possesses all these characteristics, but it also has a chronic problem: how to enlarge one's share of a market which constantly imposes more stringent technological demands. One solution is to lower sales sights and compete on price. Another is to do what is necessary to remain on top of the competition in terms of quality and service. Wallace-Murray's Illinois Gear Division has historically followed the second of these strategies. Consequently, a year ago it found itself obliged to turn down profitable potential business.

A gear is by nature a relatively small component of a larger, always far more costly machine. Yet without it, the larger machine is inoperative. Therefore, the supplier who can provide a reliable gear, and provide it with a minimum of delay, enjoys a clear competitive edge. Now, modern machines require gears which, while smaller in size, will perform at higher speeds, under greater loads, with more efficiency and less noise. This in turn obliges gear manufacturers to work to more rigorous specifications. Often, they can only be achieved by heat-treatment, a process which changes the composition of the metal and its crystalline structure in order to impart stress resistance and other qualities.

Heat treatment is part art, part science, requiring empirical skill and highly specialized equipment. Because of this specialization, most gear manufacturers, including Illinois Gear, have relied on outside sources. It became apparent, however, that quality and service, including speed of delivery, could not be assured—at least for the most demanding applications—without total in-house control. Given the certainty that designers will in future make even greater demands, it was further apparent that anyone who could satisfy these demands could anticipate greater market penetration.

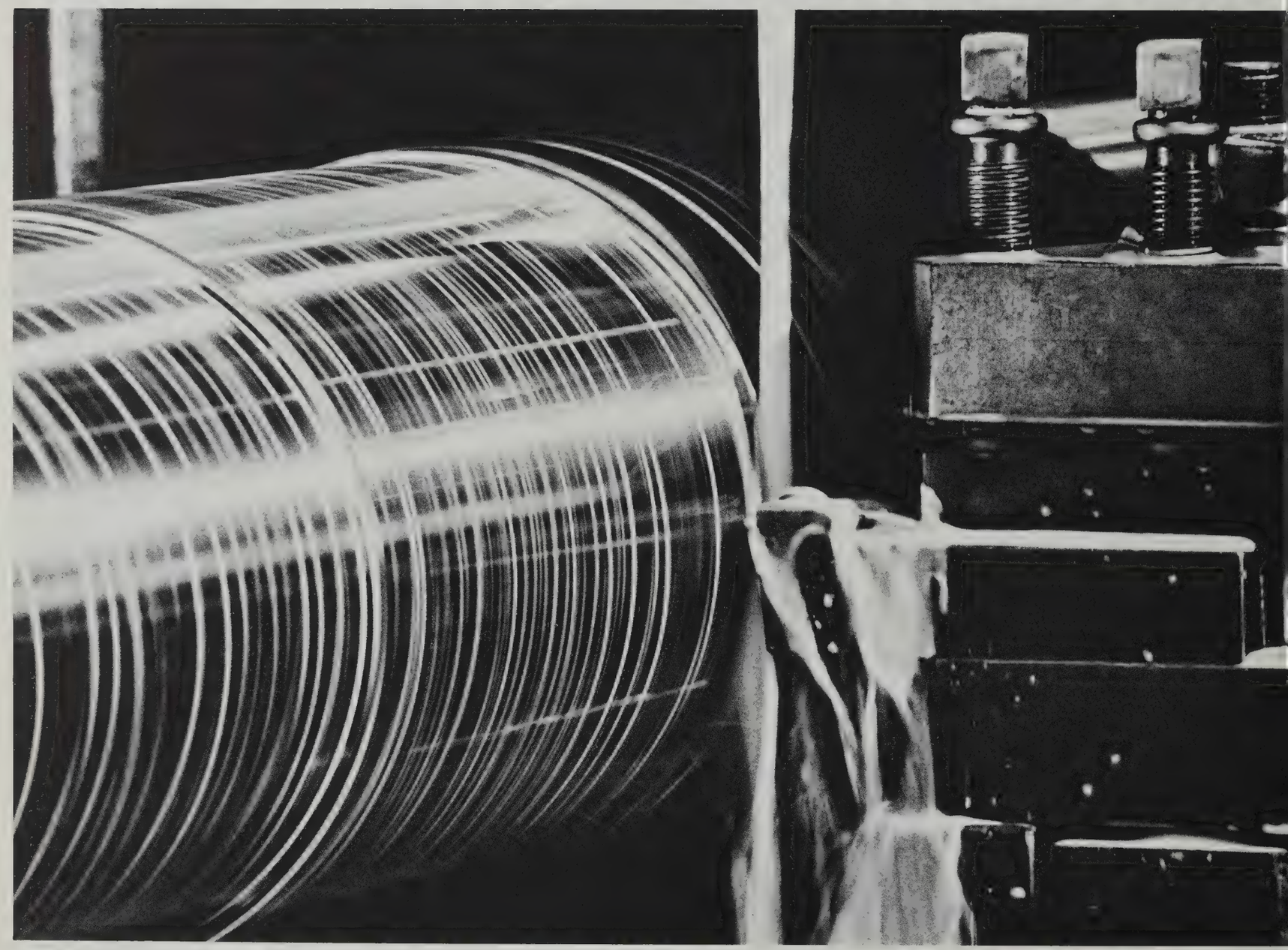


The commitment to build an in-house heat-treating facility involved the most ambitious expansion program in the history of Illinois Gear. Completed in 1970, it accounted for the sales and earnings gains posted by the division, and it is expected to make an even greater contribution as the pace of the national economy quickens.



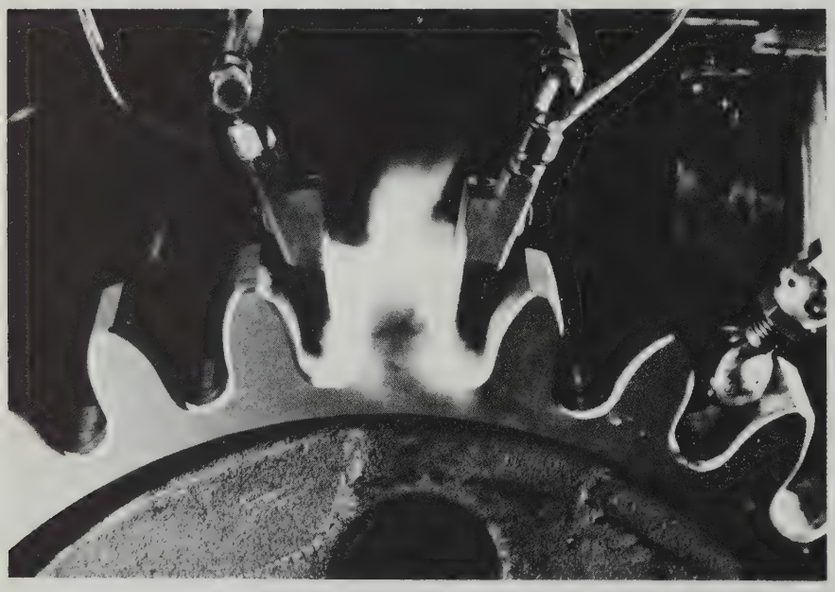
Custom gears (above) are exactly what their name describes: individually designed, milled and bored components that start as raw forgings (left) and are finished to critical tolerances for specific power-conversion uses.

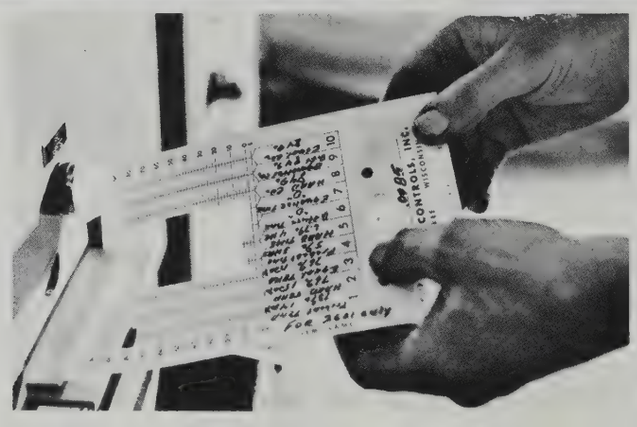
Precision, durability and performance of gears define the practical limit of modern machines—in mining, milling, transportation, agriculture, construction, manufacturing. By nature, therefore, gears are not subject to impulse buying or discretionary dislocations: the best available product within acceptable price range will generally be specified.

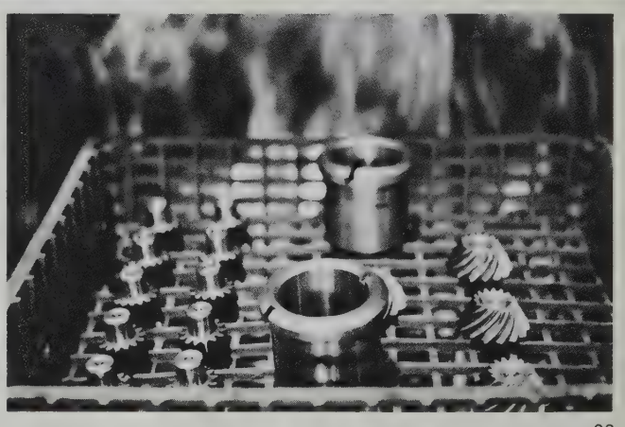


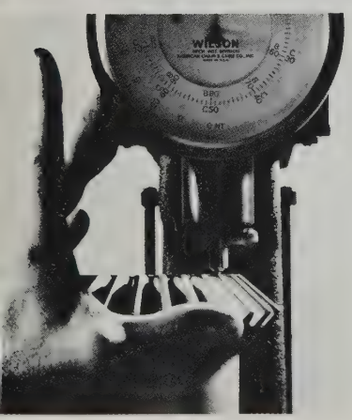
New facilities installed during 1970 include numerically-controlled machines which permit greater efficiency of operation while at the same time reducing the possibility of human error in production.

Contour induction hardening equipment (below) can accommodate gears with diameters of up to 180 inches. New deep-pit furnaces (right) have built-in controls for multi-step heating and selective carburization pre-determined by experienced metallurgists.

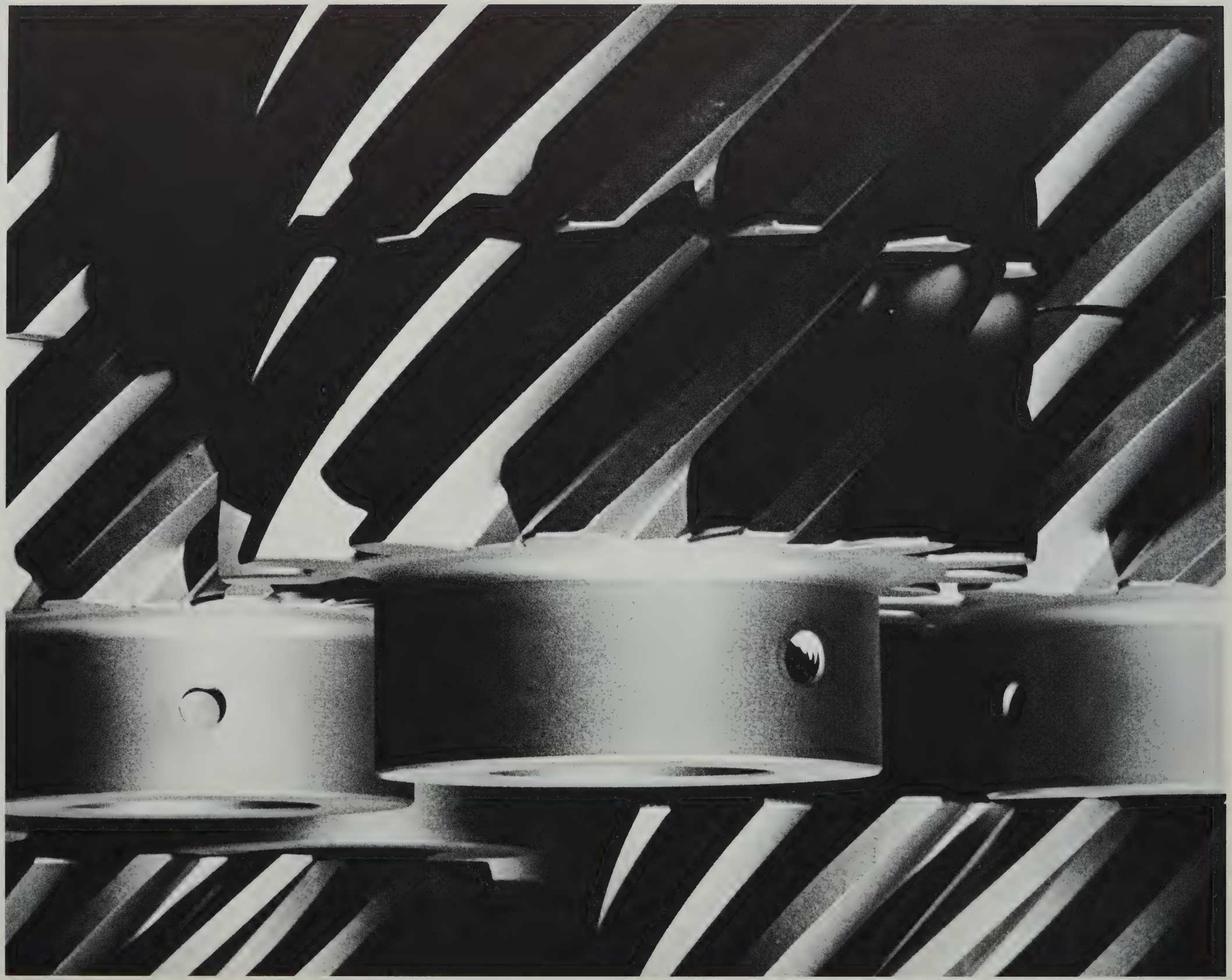








Card-controlled programs (extreme left) are unique in the industry, and can be designed to produce any desired combination of characteristics with assured repeatability. This, for the customer, means that additional orders can be handled rapidly and with assurance of reliability.



Sales, net income and earnings per share for 1970 were below the record levels attained in 1969.

Net sales were $205,604,225 as compared to $241,289,566 in 1969. Net income amounted to $6,009,419, down from $11,863,035 in 1969.

Earnings per outstanding share for 1970 were $1.47 compared with $3.48 for 1969. On a fully diluted basis, assuming full conversion of the $1.70 Cumulative Convertible Preference Stock and the exercise of Common Stock Warrants, earnings for 1970 were $1.30 per share versus $2.63 in the previous year.

The reduction in the Corporation's sales and earnings during 1970 can be attributed, to a great extent, to general economic conditions particularly as they related to housing and automotive, two of Wallace-Murray's principal market areas. The opening of Schwitzer Division's new plant at Rolla, Missouri and the subsequent write-off of nearly $700,000 in start-up costs further affected earnings. In addition, a series of internal strikes, one of 15-weeks at Scranton, six weeks at Ford City and shorter ones at Marysville, Philadelphia, Indianapolis and Brockville coupled with the extended strike at automotive customer plants such as General Motors, lowered sales and earnings substantially.

Despite the national recession, the Corporation continued its aggressive capital expenditure program. During 1970, it expended $10.7 million, the second highest amount in its history and well above a depreciation rate of $7 million, for facility and equipment modernization and expansion.

The vitreous china plant of the Eljer Plumbingware Division in Tupelo, Mississippi was increased by 200,000 square feet to triple its size in a little over three years. A new tunnel kiln and related equipment was added at Eljer's Ford City, Pennsylvania plant. As noted earlier in the Report, a new plant for the production of automotive fans and related products was completed in Rolla, Missouri, as was a major new heat treatment facility for the Illinois Gear Division in Chicago, Illinois.

Expansions were also carried out at the Simonds Saw Division in Fitchburg and at Fayette Tubular Products in Fayette, Ohio, where facilities to produce automobile air-conditioning components were increased. In addition, the Corporation completed its first overseas facility with the start-up of the Selkirk-Metalbestos plant in Barnstaple, England.

Coupled with these continued capital improvements was a reorganization of the Corporation's management structure and implementation of new and stringent controls of the business.

At the corporate level, Richard D. Castle, who had been Treasurer and Controller, was elected Vice President—Finance. J. Robert Aydelotte, former Controller of the Schwitzer Division, was elected Controller and was transferred to the corporate staff in New York, reporting to Mr. Castle.

In March, 1970, the Corporation's various businesses were divided into four product groups to coincide with their markets as indicated earlier. Raymond F. Richard, 44, who had been Vice President—Operations of the Cummins Engine Company, was elected a Group Vice President of Wallace-Murray and put in charge of the Cutting Tool and Power Components Groups. Charles V. Myers, presently a Group Vice President, assumed responsibility for the Building Products and Custom Metal Products Groups as well as the two Canadian divisions.

Four new Vice President—General Managers were named during the year. Robert J. Niehaus, 40, was elected Vice President—General Manager of the Schwitzer Division; Benno A. Bernt, 39, was named Vice President—General Manager of the Simonds Abrasive Division and Harold J. Coughlin, 49, was appointed Vice President—General Manager of the newly merged Heller and Atrax Divisions. In addition, and as a result of the acquisition of the Scharf Plumbing Supply Corporation, Mr. Arnold Kohler, 54, formerly President of Scharf, was named Vice President—General Manager of the Lawton-Scharf Division. Lawton, which was acquired in 1969, is a major supplier of plumbing supplies to the mobile homes industry as is Scharf, and the combination of these two companies under the leadership of Mr. Kohler gives Wallace-Murray a significant position in this important market.

In March, the Board of Directors accepted with regret the resignation of Howard V. Scott as a Director.

With regard to controls, and in addition to normal measures taken to achieve cost and profit goals, particular attention was given to employment levels, inventories and general administrative costs. As a result of active implementation of programs in these important areas, employment was reduced by some 20 per cent, or 2,100 employees, inventories by over $5,000,000 and administrative costs by nearly $3,000,000.

On December 3, the Board of Directors declared a quarterly dividend on the Company's Common Stock of 15 cents per share as compared to the rate of 25 cents per share which had been paid during the first three quarters of 1970. The total rate for the year was equivalent to the 90 cents paid in 1969.

On behalf of the Board of Directors, we wish to extend gratitude to our shareholders, customers and employees for their continued support and dedication during a year of challenge for the Corporation.

F. H. Kissner
Chairman

F. R. Raach
President

Consolidated Balance Sheets
December 31, 1970 and 1969

Assets	1970	1969
Current Assets:		
Cash	$ 5,415,113	$ 6,421,835
Temporary cash investments, at cost, which approximates market	4,682,500	92,500
Accounts receivable, less allowances of $904,000 in 1970 and $819,200 in 1969 for doubtful accounts	23,657,907	29,263,531
Inventories, at the lower of cost (determined on the first-in, first-out basis) or market:		
Finished goods	17,384,906	17,469,214
Work in process	15,764,341	17,484,052
Raw materials and supplies	15,878,257	19,184,730
	49,027,504	54,137,996
Prepaid expenses	616,895	871,133
Total current assets	83,399,919	90,786,995
Plant and Equipment, at cost:		
Land	3,817,377	3,739,226
Buildings	37,071,506	33,479,318
Machinery and equipment	81,950,362	76,263,220
	122,839,245	113,481,764
Less—Accumulated depreciation	55,218,994	49,254,235
	67,620,251	64,227,529
Investments and Other Assets, at cost	5,866,651	5,130,807
Intangibles (Note 3)	7,913,860	7,913,860
	$164,800,681	$168,059,191

The accompanying notes to consolidated financial statements are an integral part of these balance sheets.

Liabilities and Stockholders' Equity	1970	1969
Current Liabilities:		
Notes payable to banks	$ —	$ 6,284,684
Current portion of long-term debt	2,902,690	309,218
Accounts payable	5,766,143	8,790,283
Accrued payrolls and employee benefits	7,670,833	8,263,432
Accrued Federal and foreign income taxes	1,488,083	2,699,876
Other accrued liabilities	4,594,654	4,650,305
Total current liabilities	22,422,403	30,997,798
Deferred Federal Income Taxes	1,587,893	1,448,850
Long-term Debt (Note 4)	58,940,143	54,318,073
Stockholders' Equity (Notes 1, 5, 6 and 7):		
$1.10 Cumulative Preferred Stock, no par value, authorized 481,544 shares; held in treasury, 42,073 shares at December 31, 1970 and 41,331 shares at December 31, 1969; outstanding, 308,575 shares at December 31, 1970 and 318,545 shares at December 31, 1969, stated at $20.00 per share	6,171,500	6,370,900
$1.70 Cumulative Convertible Preference Stock, no par value, authorized 1,427,710 shares; held in treasury, 14,200 shares at December 31, 1970 and 3,900 shares at December 31, 1969; outstanding, 852,453 shares at December 31, 1970 and 871,824 shares at December 31, 1969, stated at $7.50 per share	6,393,398	6,538,680
Additional Preferred Stock, no par value, authorized 1,000,000 shares	—	—
Common Stock, $3.75 par value, authorized 12,000,000 shares; held in treasury, 345,395 shares at December 31, 1970 and 304,706 shares at December 31, 1969; outstanding, 2,833,131 shares at December 31, 1970 and 2,857,463 shares at December 31, 1969	10,624,241	10,715,486
Capital surplus	2,049,195	1,920,218
Retained earnings (Note 4)	56,611,908	55,749,186
Total stockholders' equity	81,850,242	81,294,470
	$164,800,681	$168,059,191

Consolidated Statements of Income
Consolidated Statements of Retained Earnings
For the Years Ended December 31, 1970 and 1969

Statements of Income	1970	1969
Net Sales	$205,604,225	$241,289,566
Cost of sales	159,993,405	180,248,936
Gross Profit	45,610,820	61,040,630
Selling, general and administrative expenses	30,204,390	33,176,737
Income from Operations	15,406,430	27,863,893
Interest expense	4,370,406	4,144,156
Other (income), net	(173,395)	(568,298)
	4,197,011	3,575,858
Income before Federal and Foreign Income Taxes	11,209,419	24,288,035
Federal and foreign income taxes	5,200,000	12,425,000
Net Income	$ 6,009,419	$ 11,863,035
Earnings per common share—assuming no dilution (Note 2)	$1.47	$3.48
Fully diluted earnings per share (Note 2)	$1.30	$2.63

Retained Earnings	1970	1969
Balance, beginning of year:		
As previously reported	$ 55,590,646	$ 46,611,562
Retained earnings of certain pooled businesses for which the financial statements have been retroactively restated, less amount transferred to Common Stock in the pooling (Note 1)	158,540	1,679,340
As restated	55,749,186	48,290,902
Retained earnings of certain businesses pooled during the period without retroactive restatement (Note 1)	—	92,696
Net income	6,009,419	11,863,035
	61,758,605	60,246,633
Cash dividends—		
$1.10 Preferred Stock	343,586	356,781
$1.70 Preference Stock	1,458,531	1,487,060
Common Stock ($.90 per share in 1970 and in 1969)	2,554,734	2,368,329
Dividends paid by a pooled business prior to pooling of interests	11,160	58,661
Cost in excess of par value of Common Stock (44,689 shares in 1970 and 6,000 shares in 1969) and in excess of stated value of $1.70 Cumulative Convertible Preference Stock (10,500 shares in 1970) acquired for the treasury	777,619	132,509
Cost of Common Stock warrants (30 warrants in 1970 and 1,678 warrants in 1969) acquired for cancellation	1,067	94,107
	5,146,697	4,497,447
Balance, end of year (Note 4)	$ 56,611,908	$ 55,749,186

The accompanying notes to consolidated financial statements are an integral part of these statements.

Consolidated Statements of Capital Surplus
Consolidated Statements of Source and Application of Funds

For the Years Ended December 31, 1970 and 1969

Capital Surplus	1970	1969
Balance, beginning of year	$ 1,920,218	$ 1,784,925
Proceeds in excess of par or stated value of shares issued on exercise of warrants and options to purchase Common Stock (4,940 shares in 1970 and 6,644 shares in 1969) and options to purchase $1.70 Cumulative Convertible Preference Stock (200 shares in 1970) (Note 7)	54,615	64,540
Other	74,362	70,753
Balance, end of year	$ 2,049,195	$ 1,920,218

Source and Application of Funds	1970	1969
Source of Funds:		
Net income	$ 6,009,419	$11,863,035
Non-cash charges—depreciation*	7,046,188	6,694,500
Total from operations	13,055,607	18,557,535
Net increase in long-term debt	4,622,070	—
Sale of investments	16,320	2,960,975
Sale of properties	229,860	767,787
Issuance of Common Stock and $1.70 Preference Stock	74,640	113,523
	17,998,497	22,399,820
Application of Funds:		
Additions to properties	10,668,770	11,164,099
Dividends paid	4,368,011	4,270,831
Purchase of investments	24,536	2,646,191
Purchase of treasury stock and Common Stock warrants	1,159,877	394,847
Net decrease in long-term debt	—	362,424
Other net	588,984	(258,083)
	16,810,178	18,580,309
Increase in Working Capital	$ 1,188,319	$ 3,819,511

*Depreciation is determined principally on the straight-line method.

The accompanying notes to consolidated financial statements are an integral part of these statements.

Notes

1. Acquisitions: During 1970, 65,000 shares of Common Stock were exchanged for the net assets of two subsidiaries of the Scharf Plumbing Supply Corporation, a Delaware Corporation. This exchange has been accounted for as a pooling of interests and, accordingly, the accompanying financial statements include this acquisition for all periods.

2. Earnings Per Share: Earnings per common share—assuming no dilution were computed by dividing net income, after deducting all preferred and preference dividends, by the average number of common shares outstanding during the periods, including for all periods the shares issued or contingently issuable on pooling of interests transactions.

Fully diluted earnings per share were computed after deducting only $1.10 Cumulative Preferred dividends from net income and assuming that the $1.70 Cumulative Convertible Preference Stock was converted and the Common Stock warrants were exercised.

The exercise of outstanding stock options has not been reflected in the above computations as the effect thereon is not significant.

3. Intangibles: Intangibles, which represent the cost of investments in businesses acquired in excess of amounts assigned to tangible assets, are not being amortized. In the opinion of management, there has been no diminution in value.

4. Long-term Debt: Long-term Debt at December 31 was as follows:

	1970	1969
6½ % senior notes, due 1972-1988	$37,800,000	$40,000,000
6⅞ % subordinated notes, due 1972-1988	11,670,000	12,000,000
6%-8% lease commitments, due 1972-1989	7,260,000	—
6½ % subordinated debentures, due 1972-1981	1,969,000	1,988,000
6%-7% mortgage notes, due 1972-1983	241,143	330,073
	$58,940,143	$54,318,073

The terms of the loan agreements with regard to the 6½ % senior notes and the 6⅞ % subordinated notes contain restrictions on the payment of cash dividends on the various classes of capital stock and the acquisition thereof. As of December 31, 1970, $40,205,535 of consolidated retained earnings were restricted by the terms of these agreements. Other provisions of these agreements required the Company and subsidiaries to maintain working capital of not less than $50,099,122 at December 31, 1970, on which date working capital was $60,977,516.

Similar limitations, less restrictive than the foregoing, are contained in the indenture with respect to the 6½ % Subordinated Debentures and in the Company's Certificate of Incorporation.

5. Preferred and Preference Stock: In the payment of both dividends and any preferential liquidation, the $1.70 Cumulative Convertible Preference Stock will share ratably with the $1.10 Cumulative Preferred Stock. In the event of liquidation or dissolution, the $1.70 Preference Stock will also be entitled to share ratably with the Common Stock on a share-for-share basis in the assets after payment of all preferential distributions if the liquidation is voluntary (subject to right of redemption) or, if the liquidation is involuntary, to share ratably with the Common Stock up to a limit of $30.00 per share (in addition to a $7.50 per share preferential distribution). Had involuntary liquidation taken place as of December 31, 1970, and based upon the accompanying balance sheet as of that date, the holders of the $1.70 Cumulative Convertible Preference Stock would have been entitled to receive an amount of $22,419,000, which amount includes the $6,393,398 stated value of such stock. Each share of $1.70 Cumulative Convertible Preference Stock is convertible into 1.7 shares of Common Stock. Had all such shares been so converted as of December 31, 1970, their total equity based upon the accompanying balance sheet would have been $25,610,000. During 1970, 9,071 shares of $1.70 Cumulative Convertible Preference Stock were converted into 15,417 shares of Common Stock.

The $1.10 Preferred Stock is redeemable at prices (plus accrued dividends) declining from $20.64 per share on December 31, 1970 to $20.00 per share on July 2, 1979 and thereafter. Each year the Company is required to redeem 2.5% of the shares issued as at June 30, 1969. This requirement was met during 1970 by the cancellation of 9,228 shares of treasury stock. The $1.70 Preference Stock is redeemable at $37.50 per share (plus accrued dividends) prior to October 1, 1970, but only as a whole in the event of voluntary dissolution or liquidation and as a whole or in part on and after October 1, 1970 at prices (plus accrued dividends) declining from $36.75 per share to $35.00 per share on October 1, 1975 and thereafter.

6. Common Stock: A total of 1,671,888 shares of Common Stock were reserved at December 31, 1970 for future issuance as follows:

Conversion of $1.70 Cumulative Convertible Preference Stock (each share convertible into 1.7 shares of Common)	1,449,170
Exercise of Common Stock options	184,850
Exercise of Common Stock warrants	9,868
Issuance of additional shares to former stockholders of a pooled company contingent upon market price of the Common Stock in 1971	28,000
	1,671,888

7. Stock Options: Following is a summary of changes during 1970 in outstanding options to purchase Common Stock:

	Shares Subject to Option	Option Price	
		Per Share	Total
Beginning	162,200	$16.19 to $37.00	$4,979,628
Granted	43,250	$14.50 to $23.125	872,687
Exercised	(4,000)	$17.25	(69,000)
Expired	(33,850)	$16.19 to $34.625	(952,596)
Ending	167,600	$14.50 to $37.00	$4,830,719

Options to purchase 124,850 shares were exercisable at December 31, 1970, and the remaining outstanding options become exercisable during 1971. In addition, 17,250 shares of Common Stock were reserved as of December 31, 1970 for grant of options under Qualified Stock Option Plans for officers and other key employees. Options under these Plans are exercisable during the five-year period subsequent to date of grant, at market prices on the dates such options are granted.

8. Pensions: The Company and its subsidiaries have a number of pension plans covering substantially all of their employees. The total pension expense, which includes, as to certain of the plans, amortization of prior service cost over periods ranging from 11 to 40 years, was approximately $3,255,000 in 1970 and $3,250,000 in 1969. The Company's policy is to fund pension cost accrued. The actuarially computed value of vested benefits at December 31, 1970, with respect to certain of the plans, exceeded the total of the applicable pension funds by $2,900,000.

9. Pending Litigation: On October 6, 1966 the Government filed Sherman Act indictments against fifteen plumbing fixtures manufacturers, including the Company. These Government actions were terminated as to the Company and eleven other concerns by the entry of *nolo contendere* pleas. The remaining three concerns were convicted in May, 1969. Numerous civil actions seeking the recovery of treble damages with respect to the same matters are pending; in most, the complaints do not specify the amount of damages sought. Three agreements, subject to a number of contingencies including court approval, have been entered covering claims at a number of distributional levels. Negotiations to settle the bulk of the remaining actions are in progress and the Company is defending all actions in which settlements are not indicated. In the opinion of management and counsel, these actions will not have a materially adverse effect on the Company's business, operations, or financial position. No provision has been made in the financial statements in connection therewith.

Auditors' Report

To the Stockholders and Board of Directors,
Wallace-Murray Corporation:

We have examined the consolidated balance sheets of Wallace-Murray Corporation (a Delaware Corporation) and subsidiaries as of December 31, 1970 and 1969, and the related statements of income, capital surplus, retained earnings and source and application of funds for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Wallace-Murray Corporation and subsidiaries as of December 31, 1970 and 1969, and the results of their operations and the source and application of funds for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

New York, N.Y., February 1, 1971. Arthur Andersen & Co.

Eight-Year Summary

	1970	1969
Operations		
Net Sales	$205,604,225	$241,289,566
Income Before Income Taxes	11,209,419	24,288,035
Federal and Foreign Income Taxes	5,200,000	12,425,000
Net Income	6,009,419	11,863,035
Depreciation	7,046,188	6,694,500
Cash Flow	13,055,607	18,557,535
Interest Expense	4,370,406	4,144,156
Financial Position		
Current Assets	$ 83,399,919	$ 90,786,995
Current Liabilities	22,422,403	30,997,798
Working Capital	60,977,516	59,789,197
Current Ratio	3.72	2.93
Long-Term Debt	58,940,143	54,318,073
Stockholders' Equity	81,850,242	81,294,470
Comparative Statistics		
Number of Common Stockholders	3,811	3,580
Number of Preferred Stockholders	2,985	3,021
Average Number of Common Shares Outstanding	2,871,319	2,878,229
Earnings Per Common Share—Assuming No Dilution	$1.47	$3.48
Average Number of Shares Outstanding, Assuming Full Dilution	4,343,874	4,378,047
Fully Diluted Earnings Per Share	$1.30	$2.63

All years have been restated to reflect companies acquired in poolings of interests transactions.

Fully Diluted earnings per share assumes full conversion of $1.70 Cumulative Convertible Preference Stock and exercise of Common Stock warrants.

Simonds Saw and Steel Company was acquired by purchase in late December, 1965. Accordingly, the above Summary includes the Simonds balance sheet data at year-end 1965 and operating results for subsequent years.

1968	1967	1966	1965	1964	1963
$220,650,175	$204,218,778	$205,402,613	$108,620,685	$81,887,626	$60,761,354
23,059,320	20,683,882	22,995,049	13,512,182	9,040,520	5,360,364
11,722,913	9,869,783	11,226,142	6,192,225	4,329,347	1,830,091
11,336,407	10,814,099	11,768,907	7,319,957	4,711,173	3,530,273
6,389,134	6,095,121	5,852,308	2,793,677	2,251,285	2,004,222
17,725,541	16,909,220	17,621,215	10,113,634	6,962,458	5,534,495
3,856,634	4,234,132	3,993,024	1,041,158	889,905	403,319
$ 82,942,144	$ 81,579,998	$ 84,793,030	$ 77,184,041	$48,671,951	$48,562,912
26,972,458	26,886,164	24,466,511	24,745,081	12,773,626	6,401,309
55,969,686	54,693,834	60,326,519	52,438,960	35,898,325	42,161,603
3.08	3.03	3.47	3.12	3.81	7.59
54,680,497	57,447,020	64,138,229	64,401,059	17,489,424	6,495,507
73,890,552	65,995,154	63,696,462	54,138,217	49,695,685	56,004,160
3,608	3,759	4,097	3,687	3,610	3,667
3,099	3,258	3,405	3,191	700	—
2,848,158	2,819,926	2,812,456	2,742,774	2,577,188	2,800,530
$3.32	$3.16	$3.52	$2.01	$1.25	$.73
4,378,644	4,420,347	4,537,864	4,576,228	4,318,222	4,506,029
$2.51	$2.36	$2.52	$1.55	$1.09	$.78

Wallace-Murray Corporation

Executive Office, 299 Park Avenue, New York, NY 10017

Domestic Operating Divisions

Building Products

Eljer Plumbingware

J. V. Cannon Jr., Vice President-General Manager
DIVISION OFFICE: Pittsburgh, Pa.
PLANTS: Ford City and Scranton, Pa.; Marysville, Salem and Springfield, O., and Tupelo, Miss.
PRODUCTS: Plumbing systems and fixtures including enameled cast iron and formed steel products, vitreous china, fiberglass, brass fittings and steel stampings

Lawton-Scharf

Arnold Kohler, Vice President-General Manager
DIVISION OFFICE: St. Petersburg, Fla.
DISTRIBUTING BRANCHES: St. Petersburg, Fla.; Americus, Ga.; Elkhart, Ind.; Tupelo, Miss.; Charlotte, N. C.; and Scranton, Pa.
PRODUCTS: Plumbing supplies and building components for the mobile home industry

William Wallace

H. R. Falkner, Vice President-General Manager
DIVISION OFFICE: Belmont, Calif.
PLANTS: Belmont, Calif. and Logan, O.
PRODUCTS: Gas vent systems, chimneys and sheet metal products

Dry

Hal S. Dry, General Manager
DIVISION OFFICE: Winters, Tex.
PLANT: Winters, Tex.
PRODUCTS: Registers, grills and diffusers for heating and air-conditioning

Cutting Tools

Simonds Saw

W. C. Haskins, Vice President-General Manager
DIVISION OFFICE: Fitchburg, Mass.
PLANT: Fitchburg, Mass.
PRODUCTS: Circular, band and hack saws; files; machine knives; circular cutters and steel specialties

Simonds Abrasive

B. A. Bernt, Vice President-General Manager
DIVISION OFFICE: Philadelphia, Pa.
PLANTS: Philadelphia, Pa.; Salem, Ill.; and El Monte, Calif.
PRODUCTS: Grinding wheels and abrasive grains

Heller-Atrax

H. J. Coughlin, Vice President-General Manager
DIVISION OFFICE: Newcomerstown, O.
PLANTS: Newington, Conn.; Claremont, N.H.; and Newcomerstown, O.
PRODUCTS: Precision solid carbide tools, burs, files, hammers and special tools

Power Components

Schwitzer

R. J. Niehaus, Vice President-General Manager
DIVISION OFFICE: Indianapolis, Ind.
PLANTS: Indianapolis and Elwood, Ind.; Rolla, Mo.; and Stratford, Ontario
PRODUCTS: Automotive and Diesel engine components including turbochargers, cooling fans, vibration dampers and fan drives

Fayette Tubular Products

R. E. Whiting, Vice President-General Manager
DIVISION OFFICE: Lathrup Village, Mich.
PLANT: Fayette, O.
PRODUCTS: Fluid power devices for automotive air-conditioning and hydraulic components for motor vehicles

Custom Metals

Illinois Gear

R. L. Durgin, Vice President-General Manager
DIVISION OFFICE: Chicago, Ill.
PLANT: Chicago, Ill.
PRODUCTS: Metallic and non-metallic custom-made industrial gears

Simonds Steel

C. H. Emery, Vice President-General Manager
DIVISION OFFICE: Lockport, N.Y.
PLANT: Lockport, N.Y.
PRODUCTS: Custom-made high quality alloy, tool and specialty steels

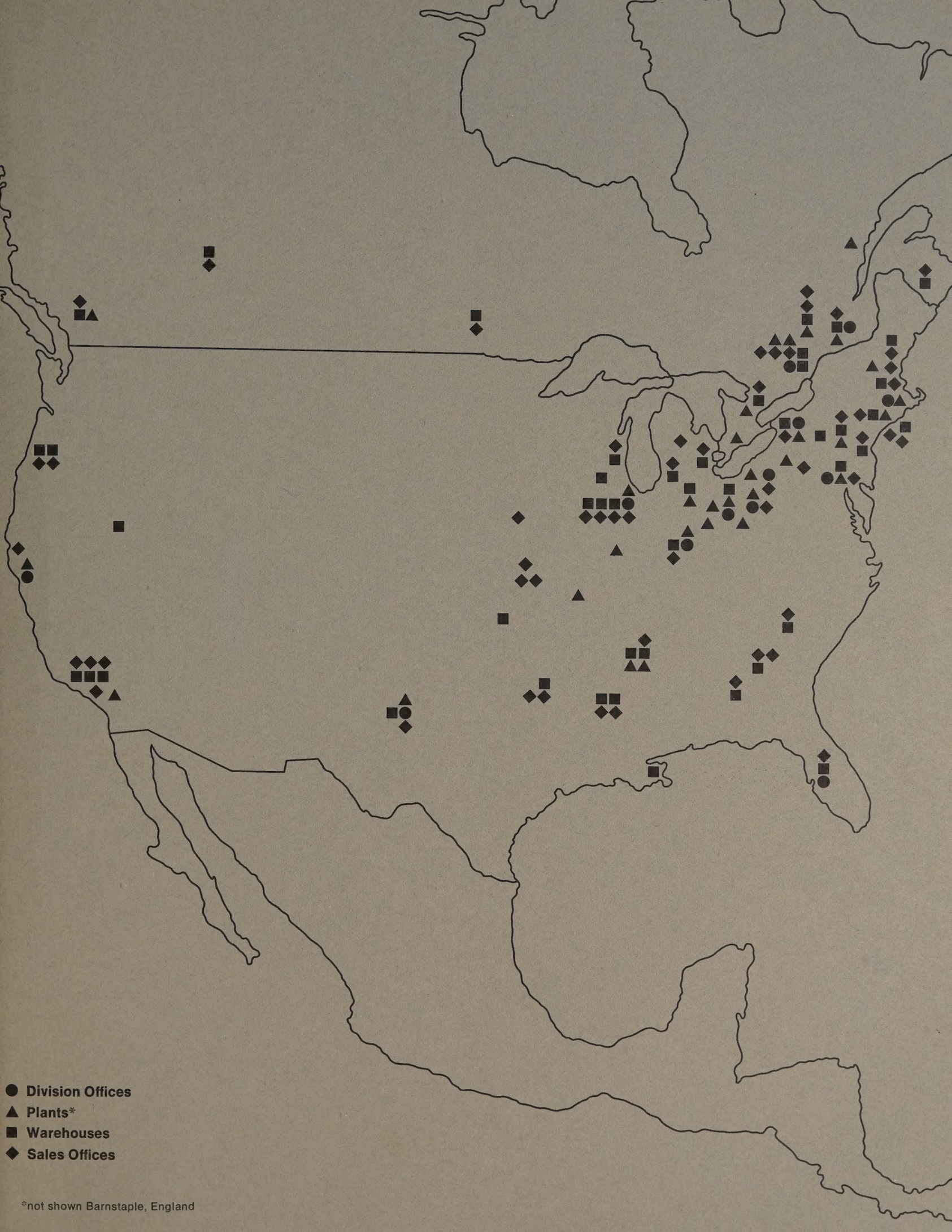
Canadian Operations

Simonds Canada Saw

J. C. Orr, General Manager
DIVISION OFFICE: Granby, Quebec
PLANTS: Granby and Arvida, Quebec; Brockville, Ontario; Vancouver, B.C.
PRODUCTS: Saws, machine knives, abrasive and diamond wheels and abrasive crude

Selkirk-Metalbestos

R. J. Loveless, General Manager
DIVISION OFFICE: Brockville, Ontario
PLANTS: Brockville and Hamilton, Ontario; Montreal, Quebec; and Barnstaple, England
PRODUCTS: Gas vent systems, industrial chimneys and fireplaces



*not shown Barnstaple, England

Directors

John D. Ames, Jr.
John B. Balmer*
Charles H. Dyson*
Franklin H. Kissner*
James A. McLean
Sylvester W. Muldowny
Robert E. Palmer
Fred R. Raach*
Bruce Williams
James O. Wright

*Members of Executive Committee

Officers

Franklin H. Kissner, Chairman of the Board
Fred R. Raach, President and Chief Executive Officer
John B. Balmer, Chairman of the Executive Committee
Charles H. Dyson, Chairman of the Finance Committee
Charles V. Myers, Group Vice President
Raymond F. Richard, Group Vice President
Benjamin G. Bowden, Vice President—Research and Development
Richard D. Castle, Vice President—Finance
John H. Long, Jr., Vice President—Industrial Relations
Arthur J. Andersen, General Counsel and Corporate Secretary
J. Robert Aydelotte, Controller

Transfer and Dividend Disbursing Agent

First National City Bank
111 Wall Street
New York, New York 10015
Common Stock
$1.70 Cumulative Convertible
Preference Stock and Warrants
$1.10 Cumulative Preferred Stock

Registrars

Bankers Trust Company
16 Wall Street
New York, New York 10015
$1.70 Cumulative Convertible
Preference Stock

Manufacturers Hanover Trust Company
4 New York Plaza
New York, New York 10015
Common Stock

Auditors

Arthur Andersen & Co.
1345 Avenue of the Americas
New York, New York 10019

Design: Arnold Saks, Inc.
Text: Mark Strage
Photography: Burk Uzzle, Magnum

Wallace-Murray Corporation 299 Park Avenue New York, NY 10017